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C O N F I D E N T I A L SECTION 01 OF 08 MEXICO 006186

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WHA FOR PDAS KELLY, DAS JACOBSEN, MEX/WOLFSON, EPSC
EEB FOR A/S SULLIVAN AND EEB/TPP/BTA DELAWIE

E.O. 12958: DECL: 12/01/2017
TAGS: ECON ETRD EFIN PREL MX VE
SUBJECT: VISIT OF ASSISTANT SECRETARIES SULLIVAN AND LOWERY
-- MEXICO ENTHUSIASTIC ABOUT EXPANDING THE BENEFITS OF FREE
TRADE WITHIN THE REGION

Classified By: Economic MinCouns Laura Kirkconnell, Reasons 1.5 (b) and (d).

Summary

¶1. (C) Summary: Over the course of meetings with prominent Mexican economic opinion leaders within and outside government, a visiting State/Treasury delegation received enthusiastic responses to U.S. ideas to establish an association of free trade partners in the hemisphere to promote competitiveness and ensure the benefits of trade are spread as broadly as possible within our societies. Mexico would be prepared for a regional group to tackle the sensitive issue of knitting FTAs together sooner than might be politically feasible in the United States. Mexican officials expressed understanding of the delicate U.S. Congressional mood on trade, and responded positively to U.S. ideas for initial areas of cooperation. The Finance and Economy Ministries discussed measures Mexico is already taking to knit together a number of its 12 bilateral and multilateral FTAs it has with 42 countries. In explaining their initiative to integrate free trade efforts among "Pacific Arc" Latin countries, Economy Ministry officials made clear they would like to see the U.S. seriously engaged as well. They said the U.S. proposal would need to do more than create another talk shop, and warned that it could not be perceived as a cloak for addressing U.S. security concerns.

¶2. (SBU) Both public and private sector officials agreed

developing infrastructure was key to spreading the benefits of free trade. They discussed the need for technical assistance to develop project proposals, find qualified investors and ensure funded projects are actually built. The head of Mexico's largest government-run development bank discussed his agency's success in reaching out to small and medium-sized enterprises. The chief of the government-run infrastructure bank discussed his agency's focus on municipalities.

¶3. (C) Secretary of Finance Carstens proposed that another deliverable might be implementing policies and practices to encourage U.S. citizens to retire in Mexico and Central America (such as allowing medicare coverage outside the U.S.) He also voiced support for the Merida Initiative to tackle organized crime and narco-trafficking. Private sector opinion leaders voiced similar views on how to extend the benefits of free trade agreements, and added strong suggestions on cumulation of origin, Open Skies, and other ways to deepen economic engagement. The Mayor of Mexico City stressed education programs (including English language) and policies to foster technology development. Private sector interlocutors noted that a lack of internal reform within Mexico was largely responsible for the benefits of NAFTA not having been spread more widely. All gave President Calderon credit for reforms he had undertaken to date, but stressed that deeper reforms are needed. Every interlocutor, public and private, who commented on Hugo Chavez expressed satisfaction that more world leaders are now standing up to his bullying tactics. They also uniformly praised the USG for staying out of the fray, which they said was the best contribution we could make to blunt his influence in the

Hemisphere. End Summary.

¶4. (U) EEB A/S Dan Sullivan, Treasury A/S Clay Lowery, WHA PDAS Craig Kelly, Treasury DAS Brian O'Neill, EEB/TPP/BTA Director Greg Delawie, and Treasury Director Luyen Tran visited Mexico City November 29-30 for meetings with the Ministries of Finance and Economy, the heads of Mexico's state-run development and infrastructure banks, the Mayor of Mexico City, and a number of well-known Mexican economic opinion leaders.

¶5. (SBU) In the meetings with Mexican federal government officials, conversation centered around the USG idea to form an association of free trade partners in the hemisphere to promote competitiveness and ensure the benefits of trade liberalization are spread as broadly as possible. Sullivan stressed that the immediate priority for the USG was the passage of FTAs with Peru, Columbia, and Panama, and noted the positive House of Representatives vote on Peru. (Note: On December 4, the Senate passed the Peru FTA with a margin of 77-18. End note.) He said that the USG wanted to consolidate and maintain the momentum of the historic achievements that have been made with regard to free trade in the hemisphere. He suggested the establishment of an association of free trade partners in the hemisphere, committed to democracy, the rule of law, and open market policies, the primary purpose of which would be to work together to promote competitiveness and ensure the benefits of trade liberalization were spread as broadly as possible in all our societies, especially to small businesses, farmers, and others who had not yet directly benefited from free trade.

¶6. (SBU) Such an association could have strong links to the private sector and could include initiatives -- such as the US Treasury,s program to enhance access to financing for small and medium enterprises (SMEs) -- to help citizens take better advantage of FTAs in the region. An important longer term goal of such an association would be to work on &knitting together8 the different hemispheric trade agreements) possibly harmonizing issues like customs procedures, rules of origin, intellectual property rights,

etc., and working on cumulation issues.

¶7. (SBU) This association of free trade partners could potentially include an administrative headquarters to serve as a coordinating body and driving force for continued progress on reducing poverty, increasing competitiveness, and strengthening social cohesion in the Western Hemisphere. It could complement the work of other institutions in the region, such as the OAS and IDB.

¶8. (SBU) Sullivan emphasized that the delegation was seeking input from the three leaders on trade in Latin America) Chile, El Salvador, and Mexico) as well as Canada - before moving forward with this idea. He noted the delegation would return to Washington to work with other agencies in the USG to consolidate the ideas of the Latin leaders and refine the proposal for final approval by the USG interagency economic team.

¶9. (U) Lowery explained that expanding access to credit and

extending infrastructure networks could make excellent areas of cooperation for such a regional initiative. Kelly put the initiative into a regional perspective and emphasized that this sort of association could complement the Merida Initiative to help Mexico and Central America combat organized crime by adding a prosperity component to U.S. regional engagement. In meetings with Mexico City's mayor and outside experts, the proposed association was not raised specifically. Instead, discussion focused on how to spread the benefits of free trade to those currently left out.

Finance Ministry

¶10. (C) Under Secretary of Finance Alejandro Werner said that Mexico was already working unilaterally to harmonize its various FTAs, including using a "least common denominator" approach for rules of origin, cumulation, tariff levels, and customs procedures. The purpose, he said, was to reduce business transaction costs and opportunities for corruption. Werner noted Mexico's efforts with Chile and the Inter-American Development Bank (IDB) to identify and eliminate differences among FTAs between Latin American countries along the Pacific Rim. He stressed that both initiatives were important to boost Mexican competitiveness, especially given a possible slow down in U.S. economic activity over the next two years.

¶11. (C) Secretary Carstens thanked the USG for its proactive attitude toward Mexico and for the U.S. ideas about expanding regional trade. He said his Ministry would be as supportive as possible of the U.S. proposal for an association of free trade partners, and would recommend that the government back it. Carstens stressed the importance of thinking clearly about the final objective, mechanism of collaboration, and deliverables, and noted that the proposal should leverage existing vehicles like the IDB. He agreed that Latin America needed to address its huge challenge of providing employment to a young population. Given demographic trends, he explained, unless we develop rural areas, we will see continued migration to urban areas within Latin America and to the United States.

¶12. (C) One specific deliverable Carstens suggested was facilitating the retirement of U.S. and Canadian baby boomers in Mexico and Central America by allowing them to receive medicare benefits there. If some of the 25 million American and Canadians expected to retire in the next 10 years came to Mexico and Central America, he argued, it would induce a huge creation of small and medium enterprises (SMEs). The U.S. side noted the political difficulties within the U.S. about extending medicare coverage to Amcits living in Mexico and Central America, but said Treasury was looking at the technicalities. Given the difficulties of fully resolving

this issue, Carstens suggested that the governments determine what Americans would need to retire in Mexico and seek a gradual way to take care of their needs. He noted that a big flow of U.S. emigrants heading from north to south might help dampen political sensitivities about the south to north flow of Mexican and Central American emigrants.

¶13. (C) PDAS Kelly noted the link between prosperity and

security, and expressed the hope that Secretary Carstens will support the U.S.-Mexico Merida Initiative to combat organized crime and drug-trafficking. Kelly noted that the Initiative included a proposed USD 5 million for the Financial Intelligence Units to receive technology enhancements (data management and analysis software and hardware). Such improvements would better link the information management systems being used to combat money laundering. Carstens responded that his Ministry was very appreciative and supportive of the Initiative, and of the work the U.S. Department of Homeland Security was doing with the Mexican government, including the recent MOU between U.S. and Mexican Customs. Carstens noted the extensive nature of U.S. and Mexican collaboration to combat the flow of drugs to the U.S. and the flow of money and arms to Mexico. He said both governments had a good level of confidence in each other, and should strengthen that confidence and extend it to Central America.

Development Banks

¶14. (SBU) Mario Laborin, chief of NAFIN, Mexico's largest government-run development bank, explained how NAFIN has improved its outreach to SMEs. Among recent changes was a requirement that by 2012 35% of government purchases be made from SMEs, and a mandate that payments to SMEs be done through a federal government electronic payment system. Laborin explained that electronic payments prevented corruption and ensured that SMEs actually got paid when they sold to the government. In a separate meeting with O'Neill and Tran, the Director General of BanObras, a government-run development bank focused on infrastructure, explained that BanObras focused on municipalities because many lacked the capacity to develop and manage infrastructure projects. These officials as well as Secretary Carstens agreed that in Mexico, financing was generally available for infrastructure projects. The problem was a lack of capacity to develop project proposals, find qualified investors, and ensure all regulatory and legal hurdles are cleared so that funded projects actually proceed.

Economy Ministry

¶15. (SBU) The team met with Beatriz Leycegui, U/S of Economy for International Trade Negotiations and Carlos Ortega Venzor, chief adviser to the Economy Secretary. Both were very enthusiastic about the U.S. proposal. Leycegui said that a number of pro-trade countries from the "Pacific Arc" (Chile, Peru, Ecuador, Colombia, the Centrals and Mexico) are already engaged in exploring deeper economic integration among themselves as a way around the failed Free Trade Area of the Americas talks, which foundered due to resistance from Venezuela, Brazil, and others. With Mexico and Chile in the lead, the Pacific Arc countries are exploring how they might establish cumulation of origin and other convergence mechanisms among the various FTAs in the Hemisphere. In fact, the IDB had already done a general paper looking at rules of origin and was poised to do a more detailed analysis of methodologies that could actually be used to achieve convergence. Given the size of the U.S. market and a general

Latin American desire to see the U.S. engage in a clear economic win-win proposition such as this, she said U.S. participation would be warmly welcomed. In fact, she said, Mexico was open to any country truly interested in freer trade and greater economic integration joining the group, including the Caribbean and Uruguay.

¶16. (C) Leycegui was disappointed that 1) the limited CAFTA-Dominican Republic textiles cumulation provisions could not be implemented between Mexico and the U.S. until all the Centrals had finished the required amendments to their laws and rules and 2) that Canada had not included cumulation provisions in its recently concluded FTAs with Peru and Colombia, but said this was clearly the direction to head in if we were serious about integration. Nonetheless, she acknowledged that protectionist politics in the U.S. (and Mexico as well) had to be taken into account and thus the more aggressive linking up of FTAs might work better as longer term goals of an association of free trade partners. Both she and Ortega were interested in the USG proposals of focusing on SMEs, access to financing, infrastructure, and English language training.

¶17. (C) Ortega echoed Leycegui's overall positive response, noting this kind of initiative would demonstrate U.S. commitment to the region. However, he asserted that for something like this association to work, there would need to be clear lead agencies in each country, or lacking that, strong participation by the various offices of the presidency (e.g., the White House, Los Pinos, etc.) to make sure the bureaucracies moved. In this respect, he cited the Security and Prosperity Partnership of North America as a good example of an initiative that worked well due to strong executive involvement, though he agreed with the USG team that the association of free trade partners would have to be organized differently. He also stressed that an association without easily identified deliverables would end up being counter-productive. Finally, he warned that Latin America's reflexive U.S. critics would be looking for signs that this was another U.S. effort to hide an unwelcome regional security agenda under an economic cloak. A/S Sullivan assured him this was not the case.

¶18. (U) Both sides noted that three meetings relevant to regional integration were scheduled to be held in April 2008: 1) the IDB annual meeting April 4-8 in Miami; 2) a meeting of the Pacific Arc countries April 10-11; and 3) the World Economic Forum for Latin America April 13-15 in Cancun, Mexico.

Mayor of Mexico City

¶19. (SBU) Marcelo Ebrard, the mayor of Mexico City, told the team that Mexico was not growing fast enough to provide good jobs for its people, noting that many well-educated citizens of Mexico City immigrated to the U.S. because of lack of opportunities. He and his chief adviser for economic competitiveness, Sam Podolsky, described a series of initiatives to improve the city's infrastructure, strengthen education, ensure public security, and attract foreign investment. After the mayor left the meeting, Podolsky also

described recent initiatives aimed at making law-abiding merchants out of informal street vendors who frequently sell pirated or contraband goods and do not pay taxes.

Opinion Leaders

¶20. (SBU) The delegation discussed how to extend the benefits of free trade over a dinner hosted by the DCM with opinion leaders from Mexico-based economic research institutes: Salvador Mallo, Director of Research for the Mexican Competitiveness Institute; Luis Rubio, President of the

Center for Development Research; Alfredo Thorne, JP Morgan Director General for Economic Investigation for Latin America; and Rogelio Ramirez de la O, Director General for ECANAL (and former unofficial economic advisor to the campaign of losing leftist Presidential candidate Andres Manual Lopez Obrador). Initial discussion concerned the heated immigration and NAFTA debate within the U.S., and how it is harming efforts to promote economic integration in the region. Alfredo Thorne expressed concern about recent statements by Presidential candidate Hillary Clinton about the "failures" of NAFTA. Salvador Mallo said that although Mexicans do not view NAFTA as having been bad for their economy, they have lost the optimism they had about their economic futures. It was understandable, he said, because around 60% of Mexicans do not graduate high school and are unprepared for the jobs and other opportunities provided by NAFTA. He said there is a widespread feeling that Mexico has "missed the boat" in terms of taking advantage of opportunities under NAFTA. Luis Rubio described how a lack of competition, credit to the private sector, and an over-regulated economy make it hard to be an entrepreneur in Mexico.

¶21. (C) All four agreed that the main reason NAFTA had failed to reduce poverty in Mexico was the failure of Mexico to open its economy to competition and enable SMEs and other new entrants to take advantage of opportunities opened by NAFTA. All gave credit to President Calderon for the reforms he has achieved to date, but stressed that more was needed, especially strengthened anti-trust measures to combat near-monopolies such as in telecommunications and hospitals. They said Mexicans were too complacent and unwilling to tackle difficult economic reforms in the absence of a crisis. Ramirez believed that declining oil production may bring such a crisis in about six years, but predicted that in 2008 Congress would pass reforms of the state energy monopoly Pemex to reduce the amount of revenue sucked away to support overall government spending, improve Pemex's corporate governance and give it more flexibility to contract for services from the private sector. Ramirez argued that the USG should encourage Mexico to undertake reforms, such as when Treasury insisted on reforms to bolster long-term macro-economic stability in exchange for support during the 1994 debt crisis. The other economic analysts did not voice support for this view, with one noting that it could be counterproductive.

¶22. (SBU) As to what the United States could do to help spread the benefits of free trade, the analysts agreed that improving infrastructure was key. They also stressed the

importance of supporting SMEs, including a recommendation that the World Bank and international institutions need to modify their rules to support SME development.

¶23. (SBU) An after-dinner discussion hosted by Fernando Solana, (former Senator, General Director of the Central Bank, Minister of Foreign Affairs, Minister of Commerce and Industrial Promotion, and Minister of Public Education) yielded a precise prescription of how to extend the benefits of free trade. Solana had gathered two fellow ex-officials who had actively worked on NAFTA: Jaime Zabludovsky, who had served as Mexico's Deputy Chief Negotiator for NAFTA and Under Secretary for International Trade Negotiations; and Luis de la Calle Pardo, also a former Under Secretary for International Trade Negotiations. Zabludovsky and de la Calle recommended cumulation of origin among FTAs in the hemisphere, starting with prompt implementation of textile cumulation provisions between CAFTA and the Dominican Republic. They argued that the USG was mistaken in believing that all CAFTA members had first to make the necessary changes to their domestic rules and laws before textile cumulation could be implemented with any of them. (Note: Embassy and Washington are confident that the CAFTA text clearly supports the USG interpretation, though actions taken

by Honduras appear to have made this a moot point. End note.) They argued that cumulation in other sectors was a logical way out of the morass left by the failure of negotiations for a Free Trade Agreement of the Americas, one that would deepen ties among participants, and turn them from competitors to partners in fostering integrated supply chains to better compete against Asia and the European Union. De la Calle later e-mailed the delegation and Post a paper making this cumulation argument.

¶24. (SBU) The second step in the prescription was improving infrastructure within the region. Zabludovsky said that countries cannot afford to wait for capital market reform in Central America, but needed to find other ways to finance the infrastructure needed to move goods covered by FTAs. Zabludovsky, de la Calle and Solana believed that infrastructure should be the main mandate of the IDB, including subsidizing projects that would not otherwise be viable through funding them at a loss. A/S Lowery noted that Latin America seems to want the IDB to be everything to everyone, but the IDB clearly needs to focus its efforts. De a Calle recommended an expansion of the NADBank mandate to cover border infrastructure.

¶25. (SBU) Other steps recommended by Solana and his compatriots were an Open Skies agreement. De la Calle opined that Mexican resistance to a cargo open skies would be overcome once the runway at the San Luis Potosi airport was lengthened because this would deprive ESTAFA, Mexico's biggest cargo airline, of the protectionist excuse that it would be at an unfair disadvantage as long its main hub could not handle large airplanes. He noted that the U.S. Trade Development Agency (TDA) was supporting the project. (Comment: TDA has funded a "definitional mission" in support of this potential project. End Comment.) Finally, de la Calle recommended pre-clearance for travelers between the U.S. and Cancun, perhaps after Mexican immigration officials had been stationed at a key U.S. airport port-of-entry like

Houston.

Comment

¶26. (SBU) It is no surprise that Mexicans welcome the U.S. idea to work as a region to boost competitiveness and spread the benefits of free trade throughout our societies. Having the highest level of income inequality in the OECD, Mexicans are well aware that they have failed to extend the benefits of NAFTA to the 40 percent of its population still living in poverty. Understanding domestic political challenges within the U.S., the Calderon Administration is taking its own initiatives to knit together its FTAs, especially in Latin America. They especially welcome USG engagement on economic integration in the hemisphere because they are concerned that anti-immigration rhetoric in the U.S. is harming U.S. and Mexican efforts to cooperate in trade, in fighting organized crime and narco-trafficking, and in other shared interests in the hemisphere. Mexicans note that their efforts to integrate Latin American Pacific Rim FTAs will encourage other countries such as Brazil to adopt more open trade policies. With respect to Venezuela, several Mexican interlocutors expressed satisfaction that "regional" leaders, including King Juan Carlos, are standing up to Chavez's bullying tactics, but welcomed U.S. restraint in staying above the fray. They appreciated the fact that instead of generating support for Chavez through public criticism, the USG was encouraging countries of the region to work together to expand the benefits of open markets and strong democracies.

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